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Veröffentlichungsversion / Published Version  
Zeitschriftenartikel / journal article

#### Empfohlene Zitierung / Suggested Citation:

Dudau, R., & Lenes, L. (2011). European Union's energy diplomacy in the wider Black Sea region. *Eurolimes*, Supl. 3, 83-101. <https://nbn-resolving.org/urn:nbn:de:0168-ssoar-292997>

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# EUROPEAN UNION'S ENERGY DIPLOMACY IN THE WIDER BLACK SEA REGION

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**Abstract.** *The present paper discusses the strategic importance that the Caspian Basin hydrocarbons (especially natural gas) have to the EU's energy security, against the background of EU's increasing dependence on gas imports from the Russian Federation. The political engagement of various political actors of the EU (the European Commission, but also Member States and international energy majors) is analyzed with respect to the advancement of the competing transport projects transiting the Wider Black Sea Region. While discussing the dimensions of EU's energy policy, the paper focuses on the energy security contribution that the Southern Gas Corridor is expected to make, as well as on the systemic constraints and opportunities brought by Brussels' new energy policy initiatives. Special attention is given to the recent articulation of a unitary and coherent energy diplomacy approach by the European Commission, and the proposal of a major investment plan in energy infrastructure. However, the paper argues that too little, too late may have been undertaken in order to turn EU's Southern Corridor into a robust and credible diversification alternative to the Russian-owned or controlled gas transport lines.*

**Keywords:** *Energy security, energy diplomacy, energy geopolitics, Wider Black Sea Region, EU energy policies, Southern Gas Corridor, Nord Stream, South Stream, Nabucco*

## 1. Introduction

On September 7, 2011, the European Commission (EC) released a communication called “On security of energy supply and international cooperation – The EU energy policy: engaging with partners beyond our borders” (EC, 2011a). This was a remarkable document, marking a strategic shift in the EU's energy policies: for the first time, the EC presented an integrated and coherent concept of common energy policy, meant to articulate

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a single voice in dealing with Europe's primary energy providers. Indeed, such a foreign policy action in pursuit of EU's overall energy security can aptly be described as energy diplomacy. Now, the meaning of *energy security* is inherently perspective-dependent: while the buyer's perspective focuses on energy availability in sufficient quantities, at affordable prices, and through secure and diversified infrastructure, the seller looks at market shares and control of the transport routes. As shall be seen below, such a perspective difference is not easily conducive to cooperation between the two sides.

In order to appreciate the novelty and relevance of EC's mentioned step, it suffices to recollect the pervasive lament about the apparent disunity in the responses of various Member States to the "gas crises" of 2006 and 2009 between Russia and the Ukraine. The "bilateral deals" that major energy companies from Western Europe, with solid support from their governments, made with Gazprom (the main gas provider to Europe by far), thus undermining Europe's solidarity in energy matters, were a tenor of policy analysis and public rhetoric, especially in Central and Eastern Europe (CEE).

First, some relevant facts: the EU imports most of its primary energy – over 80 percent of oil and over 60 percent of natural gas. Natural gas is increasingly important in the overall European energy mix, especially in the light of Brussels' ambitious goals of greenhouse gas reduction, and the assumed renunciation of nuclear energy in Germany by 2022. In 2008, 55 percent of EU's gas imports came from the Russian Federation, mostly through the Ukraine (Mitrova, 2008; Eurostat, 2008). Yet, of the EU-27 Member States, the CEE countries depend to a much greater extent on Russian imports. Not only do they import almost their entire gas supplies from Russia,<sup>1</sup> but they are also poorly connected to Europe's gas infrastructure. Also, the EU Member States of the Wider Black Sea Region<sup>2</sup> have geographic limitations hindering their ability to tap into the international trade with liquefied natural gas (LNG), mainly because the tanker traffic through the Black Sea straits is already being virtually congested.

There is a structural difference between Western Europe's ability to ensure its natural gas supplies (thanks to various pipeline providers apart from Russia, easy access to LNG supplies, and rich transport and storage infrastructure) and the Eastern European quasi-complete dependence on Russian export. As shown by Mitrova (2008: 7), while the UK, the Netherlands or Belgium depend on Gazprom's deliveries for less than 10 percent of their needs, Slovakia, Bulgaria, and Greece import over 80 percent of their gas from

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<sup>1</sup> Romania is a notable exception. It buys from Gazprom about one quarter of its gas needs – see, among others, *BP* (2011: 22).

<sup>2</sup> The Wider Black Sea Region (WBSR) refers conventionally to the six riparian states, plus Azerbaijan, Greece, and Moldova.

Russia, with several other EU member states' dependence exceeding 60 percent. In Germany, which is the main Russian gas importer (approaching 40 billion cubic meters per annum – bcma- as of 2011), Gazprom's market share is almost 40 percent (BP, 2011). However, Berlin's energy relations to Moscow can be confidently described as “complex interdependence”, to use Keohane and Nye's (1977/2000) celebrated phrase; that is to say, unlike the CEE Member States, thanks to its market size and ability to diversify its supplies, Germany's – but also France's and Italy's, to varying degrees and for different reasons – dependence on Gazprom is essentially of a symmetric type.

Accordingly, the notion of “energy security” rings differently in the CEE, emphasizing the diversification of supply sources and import routes. Indeed, the intra-European cleavage of perceptions in energy security policies has been widened by the November 8 inauguration of the Nord Stream pipeline's first leg, but also by Germany's May 2011 political decision to speedily decommission its nuclear energy plants. These steps are likely to have ample effects upon the continental energy security arrangements, and to exert considerable pressure on the already vulnerable Member States of CEE. As indicated by Nye, “manipulating the asymmetries of interdependence can be a source of power in international politics” (Nye, 2005: 202).

It is against this background that the mentioned communication of the CE appears to be particularly salient.

## **2. EC's energy policies**

As pointed out by Kirchner and Berk (2010: 869), the EU-level measures toward a common energy policy go back a long way; thus, “one of the Euratom provisions stipulates that Member States cannot buy more than 20 percent of their uranium from a single non-EU supplier.” But then, in the aftermath of 1973's oil shock, instead of forging a common external energy policy, the Member States turned to individual approaches – as we shall see in the next section.

More recently, the EC addressed the issue of EU's external energy security in its 2008 *Second Strategic Energy Review*, titled “An EU Energy Security and Solidarity Action Plan”. That document, approved by the European Parliament in March 2009, lays out a strategic plan focusing on energy infrastructure development and supplies diversification, on building hydrocarbon stocks, and increasing energy efficiency. For natural gas, the *security of supply* injunction translates into the goal of achieving a level of diversification away from Russian sources and pipelines. For its Black Sea vicinity, the EC has prioritized the creation of the so-called *Southern Gas Corridor* “for the supply of gas from Caspian and Middle Eastern sources” (EC,

2008b: 5). We discuss in more detail the development of the Southern Corridor in the next section.

A second component of EU's energy policies is about the internal energy markets of electricity and natural gas, which ought to be turned, respectively, into unified and fully liberalized utility markets. The latest regulatory steps in this respect are outlined in the *Third Energy Market Package* (TEP) – proposed by the CE in September 2007, approved by the European Parliament in September 2009, and due to have been implemented into national legislation by the Member States by March 3, 2011. Nevertheless, so far no Member State has completed this step. TEP consists in two Directives on the electricity and gas markets, respectively (2009/72/EC and 2009/73/EC) and three Regulations regarding the access conditions to the gas transmission networks, the network for cross-border electricity exchanges, and the creation of the Agency for the Cooperation of Energy Regulators (ACER). Because it turned out that a block in the way of more substantive market liberalization was the exclusive control that major energy producers exerted upon the transport networks, precluding competitors from market access, TEP has been aimed at “ownership unbundling,” that is at dismantling the vertically integrated companies by separating transmission from supply activities. More specifically, TEP envisages to reach (a) the independence of the transport system operators (TSOs) from the control of particular energy producers; (b) non-discriminatory access for “Third Parties” to the retail distributions both in the electricity and gas sectors; (c) the autonomy of the national energy regulators, with management and finances outside the political control; and (d) adequate social protection, without distortions of market competitiveness (Dudău and Simionel, 2011: 70).

A third major component of EU's energy policies is the *Climate and Energy Package*, issued in January 2008 (EC, 2008a), which launched the “20-20-20” slogan: a reduction of EU's greenhouse gas emissions of at least 20% compared to the 1990 levels, a commitment to a target of 20% of the EU energy consumption to come from renewable resources, and a 20% reduction in primary energy use by improving energy efficiency. The goals have been reiterated in the ambitious *Europe 2020* growth strategy of 2010 (EC, 2010). In practice, these measures against global warming give special weight to natural gas consumption within EU's energy mix, since gas is the “cleanest” of all hydrocarbons.

The Treaty of Lisbon is emphatic about the “spirit of solidarity” between Member States with regard to energy matters. Indeed, Article 175A enjoins the EU to “(a) ensure the functioning of the energy market; (b) ensure security of energy supply in the Union; (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and (d) promote the interconnection of energy networks.” (*Official Journal of the EU*,

2007/C 306/01). However, for several historical, economy-structural and geographic factors, the above delineated energy policies have largely remained mere desiderata. Let us analyse those factors in turn.

### **3. The Member States' national energy security strategies**

As hinted upon, the Member States have individually developed their own energy sectors by following different strategies. After the OPEC oil embargo of the 1970s, they chose to rely on different energy mixes, provided for from different sources. Some (France, Belgium) chose nuclear energy, some diversified suppliers from OPEC to non-OPEC, and some (for example, the UK and the Netherlands) invested in the production of indigenous energy resources (North Sea oil and gas) (Kirchner and Berk, 2010: 869).

Meanwhile, Austria, Germany and Italy resorted to natural gas imports from the Soviet Union. In fact, a handful of European large energy firms have a decade-long experience of cooperation with Gazprom, since the latter was still the Soviet Ministry of Natural Gas. As pointed out by Rawi Abdelal, "the Germans and Italians have the longest-standing relationships. Eni and Gazprom concluded their first contract in 1969. The first Ruhrgas-Gazprom contract dates to 1973, and Burckhard Bergmann, the CEO of Ruhrgas between 2001 and 2008, has served on Gazprom's board of directors since 2000. Wintershall and Gazprom established their first of several joint ventures in 1993 with the creation of WINGAS, with the German firm owning fifty percent plus one share. For these firms, Russia is not a threat, but a long-standing partner" (Abdelal, 2011: 29).

But North Sea oil and gas production peaked, for most fields, by the early 1990s. Meanwhile, Mitteleuropa and the eastern part of the continent grew increasingly dependent on Russian gas, as their domestic hydrocarbons production continued to decrease. This, again, has had a differential effect upon the energy markets of the CEE Member States, on the one hand, and those of Germany, France and Italy, on the other hand. The latter have felt protected from the threat of over-dependency by the sheer size of their markets. Accordingly, those countries' governments have chosen to protect their own national energy champions, engaged in long-term contracts with Gazprom. The outlook of these companies has been shaped by their own lucrative experience with Gazprom. Confident that Russia depends on Europe at least as much as Europe depends on Russia, those CEOs, along with many political decision-makers in their states, view the overall energy relation with Gazprom as beneficial and mostly predictable, based on commercial interests. Among others, they tend to see as a liability Russia's dependence Ukraine's pipelines system, and are inclined to look favorably at any commercially viable transport

project promising to simplify and stabilize their relations with the Russian monopolistic gas exporter.

In 2005, Gazprom formed the Nord Stream consortium with BASF's Wintershall and E.ON's Ruhrgas; later on N.V. Nederlandse Gasunie and GDF Suez also joined. The construction of the offshore 55 bcm Nord Stream pipeline began in April 2010 and its first leg linking Russia's Vyborg to Germany's Greifswald was finished in the summer of 2011 ([www.nord-stream.com/pipeline](http://www.nord-stream.com/pipeline), 2011). The official inauguration took place on November 8, 2011 (*EurActiv*, 2011). The total cost has already exceeded €7 billion, with Gazprom set to invest an additional €1.3 billion in the onshore section (Smith, 2011: 121)<sup>3</sup>.

Then, for Russia's southern flank, Gazprom and ENI formed in 2008 the South Stream consortium, intent on constructing an offshore pipeline underneath the Black Sea, from Russia to Bulgaria, and to ship gas further into Southern and Central Europe. Both Nord Stream and South Stream were conceived essentially as means of "dis-intermediating" the transit states – Ukraine in the first place, but also Poland and the Baltics. The diplomatic protests from the latter countries came out loud and clear: In 2006, Radosław Sikorski, back then Polish defense minister, graphically labeled Nord Stream the "Molotov-Ribbentrop pipeline." Sikorski's hyperbolic utterance certainly translates a pervasive and acute concern in the CEE that Russia may use Gazprom's monopolistic position as a foreign policy tool of coercion upon its closer and more vulnerable neighbors. In fact, a strategy along those precise lines was articulated by Vladimir Putin already in his 1997 doctoral dissertation at St Petersburg's Mining Institute, "The Strategic Planning of Regional Resources", in which Russia's strongman articulated his views about the role of energy in the reconstruction of the Russian state and its international place (Stuermer, 2008: 44). Russia's Energy Strategy until 2020 also explicitly assumes the purpose of converting energy trade into foreign policy influence. In practice, Moscow's relationship with Belarus has evolved along this line, with Ukraine appearing to follow suit. Over the past few years, Moldova, Georgia and Lithuania had to come to terms with Gazprom's turning off the oil and gas

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<sup>3</sup> Nord Stream is to be linked through two pipelines to the Central European network. The first one, OPAL (*Ostsee-Pipeline-Anbindungs-Leitung*), which is already under construction, will extend 470 km to link Nord Stream to JAGAL, the German segment of the Yamal pipeline. The second one, NEL (*Norddeutsche Erdgasleitung*) is planned to link Nord Stream to STEGAL, at the Czech border, through MIDAL (*Mitte-Deutschland Anbindungsleitung*). The two interconnectors belong to Wingas (the Wintershall-Gazprom joint venture) and are due to come on-stream in 2011. These facts support our conjecture that European energy security is largely driven from West to East by the business interests of European energy majors, in partnership with Gazprom.

spigot. Hence, the apparently squeamish East Europeans have some worrisome instances to draw upon in feeding their perceptions of Russia's international reassertion.

We shall have more to say about South Stream's role and implications in subsection 4.2, focused on the pipelines politics of the Black Sea region. Until then, let us refer to another factor of imbalance in Europe's energy policies: the mentioned German decommissioning of nuclear energy. Decided upon hastily, in the wake of the March 2011 Fukushima disaster, the ongoing *Energiewende* has in fact built upon a popular wave of green politics in Germany. However, its environmental goals have generated unintended effects: the insatiable German need for energy led to increased consumption of fossil fuel-generated power. A federally subsidized program for gas and coal power plants has been put up, financed from the governmental Green Fond (Drieschner, 2011). In this context, Gazprom and RWE closed a deal for the construction of new conventional power plants in Germany. It has been argued that this partnership did in fact deal a deadly blow to the EU's flagship project of the Southern Corridor, Nabucco (Brueggmann, 2011; *Petroleum Economist*, 2011); we shall look into it in more detail in the next section. Also, the Czech company CEZ plans the construction of a new coal plant in Sachsen-Anhalt (Wiesmann, Belton, 2011). Ironically, by taking this path, Germany becomes less able to keep its ambitious 2020 greenhouse gas reduction goals. Furthermore, with Nord Stream's recent inauguration, the road for further massive imports of Russian gas is open.

Apart from deepening the German economy's dependence on Gazprom, Nord Stream is consequential in more than one way for the overall energy balance in Europe. For one thing, Germany's growing consumption of natural gas is likely to funnel the bulk of Russia's exports towards it, to the effect of raising Moscow's leverage upon the smaller gas importers of the CEE. Those states are small markets for the Russian gas, and also relatively poorly interconnected with Northern and Western Europe's gas grids. The increased West-European demand will allow Moscow to keep raising the gas prices, for Gazprom is already struggling to keep a steady level of production: According to the World Bank's 2010 *Energy Outlook for Eastern Europe and the former Soviet Union*, "just to maintain gas production levels, Gazprom would need to invest about \$15 billion a year; to meet potential increases in demand, capital investment would have to increase to \$20 billion a year" (World Bank, 2010: xx). Under these circumstances, with the "market price" for natural gas in fact imposed by Gazprom's through long-term contracts, most CEE states tend to see a risk of being squeezed (financially and in terms of energy access) between Western Europe and Russia (World Bank, 2010: 7-8).

The Lisbon Treaty does leave Member States the unquestionable right to build up their own energy mix. However, as rightly pointed out by David



Buchan “Germany’s nuclear decision in May 2011 shows that this treaty right should be modified to state that a member state should consult at least on the timing and pace of any change in its energy mix affecting its EU partners. Such a modification, on its own, would not justify a treaty revision” (Buchan, 2011: 5).

Finally, the Third Energy Package (TEP) has brought uneasiness and discontent among national governments and some major energy companies all over the EU. Some Member States, such as France, have a tradition of monopoly and vertical integration. As German and Italian large energy companies are bound in time-tested lucrative deals with Gazprom, the latter’s business model runs against TEP’s grain. Then, in the CEE, a mix of disappointment and concern about that perceived “lack of solidarity” EU-wide in energy issues has bolstered a breed of self-centered, uncoordinated planning. In particular, TEP is seen as either useful or detrimental, depending on the circumstances of specific deals. For illustration, Poland’s recent option for import more Russian gas confronted Warsaw with a problematic side of TEP: the Yamal-Europe gas pipeline, on which the imports depend, is a \$15.6 billion investment that has Gazprom operated and partly owned in Poland, through EuRoPol Gaz. The deal needed an exemption from TEP’s unbundling requirements, and the ensuing give-and-take between Warsaw and Brussels, which ended in a compromise, led to warnings from the EC about an infringement case against Poland. On the other hand, Lithuania has used TEP as an instrument in trying to diminish Gazprom’s leverage upon the Lithuanian gas system. Gazprom owns 37.1 percent of the country’s main gas company, Lietuvos Dujos, while E.ON Ruhrgas has 38.9 percent. Vilnius decided to separate gas supply from transport assets, invoking European legislation. Expectedly, Gazprom has protested vigorously, calling Lithuania’s action an “effective nationalization”.

It should be clear that the three dimensions of EU’s energy policy are systemically inter-related, and that coherent energy planning, domestically and at EU level, is of the essence.

## **4. Energy politics in the Wider Black Sea Region**

### **1.1 The Southern Corridor projects**

The aftermath of the Cold War set the conditions for a competitive “game” of pipeline projects, with heavy geopolitical stakes. The Wider Black Sea Region states have seen their geography enhanced to a strategic level due to new hydrocarbons discoveries in the Caspian Basin, in the early 1990s, and the efforts of delivering those resources to the Western markets. Indeed, the states

along the road – Georgia, Turkey, Bulgaria and Romania – have considered both the opportunity of acquiring new oil and gas supplies, as well as the political and economic benefits of being transited by flows of hydrocarbons.

With Western political, technical, and financial support, two major non-Russian pipelines were completed in 2005 and 2006, respectively: the Baku-Tbilisi-Ceyhan oil pipeline, transporting Azerbaijani oil to the Mediterranean port of Ceyhan (Turkey); and the Baku-Tbilisi-Erzurum gas pipeline (better known as the South Caucasus Pipeline) running parallel to the former up to Erzurum, in eastern Anatolia. Thus, the idea of a major pipeline to ship natural gas from the Caspian Basin to Central Europe came naturally: Nabucco was born as a concept in 2002 and took almost a decade to develop until its technical, legal, and financial niceties have been laid out. Nonetheless, as shall be seen below, if anything, the odds that it will be implemented have recently dwindled.

Nabucco is currently planned to start being constructed in 2013 from the Georgian-Turkish border ([www.nabucco-pipeline.com](http://www.nabucco-pipeline.com), 2011), and to transport Caspian gas westwards through Bulgaria, Romania, Hungary, and Austria, till the terminus hub, close to Vienna. The line's total length is put to 3,900 km. The first gas is expected to flow in 2017, just when Azerbaijan's Shah Deniz offshore gas field is expected to reach full development and supply an added 10 bcma. The pipeline is planned to reach a maximum output of 31 bcma by 2018. The initial cost estimate was €7.9 billion – though the consortium admits the final costs may be raised due to a rerouting of feeder lines from Northern Iraq and to the rising cost of steel (Andre, 2011). The shareholders are OMV (Austria), MOL (Hungary), BEH (Bulgaria), Transgaz (Romania), Botas (Turkey), and RWE (Germany) – all with equal parts.

After years of inactivity, it was really the Russo-Ukrainian gas spat of January 2009 that triggered a more substantive level of political interest in Nabucco. An intergovernmental agreement was signed in Ankara in July 2009. As the flagship project of the Southern Corridor, Nabucco has enjoyed a sound level of support from the EC. Nonetheless, it has been looked at with no enthusiasm by the main energy states of Western Europe. The point has been well made by Katinka Barysch: “Angela Merkel, the German chancellor, has been lukewarm about Nabucco and initially vetoed the EU's €200 million grant [for the initial feasibility study] to the pipeline (officially because she did not want EU stimulus money to be spent outside the EU). She later spoke out in favor of Nabucco, but only after the EU reconfirmed its support for the German-Russian led Nord Stream – despite visceral opposition from Poland and other member-states. Neither has Nicolas Sarkozy been a champion of the Southern Corridor. The Turks ... had rebuffed Gas de France's offer to join the Nabucco consortium. Sarkozy now seems to prefer that France's big energy company join forces with Gazprom: Gas de France joined the Nord Stream

project in March 2010 while Electricité de France is rumored to be talking about participation in [Gazprom's] South Stream. ...Silvio Berlusconi also prioritizes bilateral relations with Russia. Italy's ENI is Gazprom's main partner in South Stream. That leaves the UK as the strongest backer of Nabucco among the big Member States" (Barysch, 2010: 3).

Indeed, the initial lukewarm commitment largely explains why a project making political and economic sense has suffered so many delays. Yet after several years of sluggish progress, a number of steps of increasing significance started to be made by early 2011. A breakthrough for the Southern Gas Corridor was the joint declaration signed in Baku on January 13, 2011 by President Ilham Alyiev and EC President José Manuel Barroso, through which Azerbaijan commits to opening-up the Corridor with sufficient gas supplies (Hall and Roberts, 2011: 5). The next day, Turkmenistan's president declared his country's readiness to "collaborate with our counterparts from the EU". Turkmenistan took a subsequent step forward with Ashgabat's March 1 international conference on the "Environmental Aspects of Trans-Caspian Pipelines." As noticed by Socor (2011a), "the government initiated the conference to advance a detailed ecological case in favor of laying a gas pipeline on the seabed to Azerbaijan."

Nonetheless, a real difference in terms of EU commitment to the Southern Corridor came as recently as September 7, 2011, with the mentioned EC Communication setting the ground for unified energy diplomacy of the EU Member States. A practical follow-up of that strategic document came on September 12, when the EC mandated the facilitation of negotiations between Azerbaijan and Turkmenistan to speed up the construction of a trans-Caspian gas pipeline.

Further, on October 19, the EC President announced a major infrastructure investment plan called "Connecting Europe," envisaging the allocation of €50 billion from the EU's 2014-2020 budget for transport, energy, and communications infrastructure. Out of that, €9.1 billion is to be invested in energy transport infrastructure and climate protection measures (*EurActiv*, 2011a). The strategic proposal is to define and approve "projects of common interest," speed up their approval procedures and secure the necessary funding. For the latter purpose, the "Connecting Europe" plan will be backed by the "Project Bond Initiative," designed to act "as a catalyst to re-open the debt capital market (currently largely unexploited for infrastructure investments following the financial crisis) as a significant source of financing in the infrastructure sector" (EC, 2011). EU budget funds, combined with European Investment Bank financing, are expected to "reduce the risk for third party investors" (and thus mobilize additional "long-term private sector debt financing"). The €9.1 billion amount, although only a small part of the estimated €210 billion needed for Europe's energy infrastructure until 2020, is

several orders of magnitude higher than the amounts previously made available through the so-called Trans-European Networks-Energy (TEN-E) program. Notably, the Southern Gas Corridor is one of the 'Energy Infrastructure Priorities' identified in that strategic plan. Thus, Nabucco received a morale boost in addition to the financial one (Dudău and Guşilov, 2011: 71).

In order to better understand the significance of these commitments, one ought to ponder the main ground of skepticism about Nabucco: its apparent lack of gas supplies. Azerbaijan is the main candidate for opening-up the pipeline. Turkmenistan, with its huge reserves, comes next in line; Kazakhstan would likely also sign up to the endeavor once a Trans-Caspian connection was in place – and Russia vehemently opposes one. Iran, Iraq, and even Egypt and Qatar are also listed as possible suppliers. All in all, however, due to its geographic position, Azerbaijan is by far the most important potential source. The first stage of its offshore Shah Deniz field has been delivering since 2007 about 7 bcma to Turkey. The Southern Corridor counts on production from the fields' full development (also known as Shah Deniz 2), envisaged to be on-stream by 2017. As we shall see below, October 1, 2011 was the bidding deadline for the extra 10 bcma expected to be made available from Shah Deniz 2. Apart from Nabucco, other contenders made their bids.

Some analysts argue that an alternative more affordable than Nabucco is to "build incremental elements of infrastructure that add to existing capacity, thereby providing new or expanded linkages between customers and suppliers. These are typically pipeline interconnectors between existing networks and LNG terminals" (*Oxford Analytica*, 2010). Fact is that 7 bcma of gas from Azerbaijan have been reaching Greece since 2007, through the Turkey-Greece gas pipeline. The line was built by a joint venture of Turkey's Botas and Greece's Depa gas companies, across the Marmara Sea. Capitalizing on this line, the ITGI (Turkey-Greece-Italy Interconnector) project endeavors to reach Italy, extending from Komotini to the Thesprotia western coast of Greece and further to Otranto through a 217 km-long offshore interconnector across the Ionian Sea – a joint venture of Italy's Edison SpA and Depa. The conduit is due to deliver 8 bcma by 2017, at a cost of €1.1 billion.

Another "interconnector" is the Swiss-Norwegian-German TAP (Trans-Adriatic Pipeline) joint venture planned to transport 10 bcma of gas (to be doubled in a second phase) from Turkey to Italy through Greece and Albania, underneath the Adriatic Sea. It is also expected to be completed in 2017, at a cost of €1.8 billion. ITGI and TAP compete with each other – and both of them with Nabucco – for Shah Deniz 2's production. Both of them are included in the EU's Southern Corridor.

Importantly, though, the two interconnectors, as strictly commercial enterprises lack strategic significance in any politically substantive relevant to Europe's energy security: ITGI and TAP would ship relatively minor volumes

to the “Italian gas market, which is already saturated with supplies from well-diversified sources” (Socor, 2011a). Nabucco, on the other hand, has strategic value to Europe’s energy security, and especially for the CEE countries, already deeply dependent on Russian imports.

Still, other contenders kept coming out competing for exactly those limited volumes of Azerbaijani gas. In September 2009, Presidents Alyev and Băsescu discussed in Bucharest the possibility of developing an LNG system for the export of Azerbaijani gas via the Black Sea. Dubbed AGRI (Azerbaijan-Georgia-Romania Interconnector), the project envisions piping between 2 and 7 bcm of gas from Baku’s Sangachal terminal to the Georgian port of Kulevi, liquefying and then shipping it with LNG tankers to Romania’s port of Constanta. On February 12, 2011, the ministers of energies of Azerbaijan, Georgian and Romania, joined by the Hungarian one, signed in Bucharest a resolution through which Hungary’s state-owned power holding MVM joined the venture<sup>4</sup>. Hungary’s participation in the project was made possible after the opening of the Arad-Szeged gas interconnector, at the end of 2010.

Now, the commercial and political chances of a small scale LNG system confined to the Black Sea do not look too well. AGRI has against itself a host of important factors: the high cost of the needed LNG facilities; the Turkish antipathy toward any Caspian gas project that would circumvent its territory – which would likely translate in Turkish stranglehold of LNG tanker traffic through the Straits; dependence on the fragile Georgian corridor, absent Western involvement in the project; and an obviously cold shoulder from the EC. On the other hand, if AGRI is to stand any serious chance, then it is pending on the progress of its onshore competitors for the Shah Deniz 2 gas.

By October 1, 2011, the three contenders for the Shah Deniz 2 production made their formal bids in a tender organized by SOCAR (State Oil Company of the Azerbaijan Republic) for the selection of its preferred gas link to Europe. The decision is due to fall in the coming months. Nonetheless, as if to make the Caspian gas contest all the more confusing, British Petroleum (BP) has made its own bid for Shah Deniz’s gas. Importantly, BP also operates Shah Deniz and has a 25.5 percent stake in it.

The name of BP’s surprising proposal is South East Europe Pipeline (SEEP). SEEP’s concept is rather to upgrade existent infrastructure, more or less following in Nabucco’s proposed track. More precisely, the line “would use existing pipelines and interconnectors for about two thirds of the 3,800 kilometer route from Central Anatolia to Central Europe. It would require laying some 1,300 kilometers of new pipelines on several portions of that

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<sup>4</sup> The four companies (Romgaz, Socar, GOGC and MVM) will each hold 25 percent of the shares.

route” (Socor, 2011c). This move certainly complicates the politics of the Southern Corridor, leaning the odds against Nabucco. Like ITGI and TAP, SEEP is “nonstrategic” in nature, that is, it has merely a commercial dimension. As such, it cannot make a sizeable contribution to EU’s energy security, since the market forces alone are unlikely to overcome the Russian resistance against a trans-Caspian gas pipeline. But then there may be more to it than meets the eye. Here is a telling quote from Mathew Hulbert (2011): “In tabling the SEE Pipeline, BP may have decided to have a bilateral discussion with Moscow. BP knows how important South Stream is to Moscow’s structural designs over European gas – just as much as Moscow knows how crucial an upstream Arctic stake is for BP. So business can be done”.

This, of course, is only a supposition, though a plausible one. But we can also find other hints about BP’s strategic take of the issue. In February this year, BP released a cost assessment for Nabucco, almost doubling its estimate from €7.9 billion (the consortium’s own initial estimate) to €14 billion, mostly based on “soaring commodity prices” (especially iron ore). But the British energy major did not pay equal attention to the cost estimates for Nabucco’s competitors, although those would also be affected by rising commodity prices. True, because they would be shorter, ITGI and TAP would be less affected by the increasing steel price; and also true, as they are both planned to start operating at full capacities (unlike Nabucco’s initial one third of the full volume), the increase would be less painfully felt. Yet, the cost of upgrading the existing Turkish gas grid, on which the two interconnectors count, is likely to be higher than admitted. Also, while Nabucco already rests on an international treaty among the transit states, the juridical regime of the interconnectors’ use of the Turkish pipelines remains to be sorted out.

In any event, SEEP’s last minute arrival complicates Nabucco’s outlook. The fact that Shah Deniz’s main shareholders (BP and Statoil, both owning 25.5 percent) favor solutions different from Nabucco (importantly, Statoil owns 42.5 percent of TAP), instead preferring scalable, cost-effective pipelines, just suited to take over Shah Deniz’s 10 bcm as of 2017, leaves space place for a future trans-Caspian pipeline. Thus, they effectively downgrade the Southern Corridor’s capacity, and thereby its level of contribution to Europe’s energy security.

While we are still trying to assess Nabucco’s odds, others did form strong convictions some while ago. *Petroleum Economist* (2011) underscores Nabucco’s uncertain gas supplies (given the political complications of tapping into Turkmenistan reserves, and the political risk of investing in Iraq’s Kurdistan) and the uncertainties downstream, on the European markets (given the recent LNG glut in Western Europe and the newly factored potential of the so-called shale gas). Then, as indicated by Brueggmann (2011), quite a few experts and pundits took RWE’s mentioned deal with Gazprom this past

summer as a watershed moment: when such an important Nabucco shareholder as RWE joins forces with the Southern Corridor's main competitor, little political and business impetus remains for Nabucco to be implemented. To better understand why this is the case, we ought to discuss about Nabucco's true nemesis: South Stream.

## **1.2 The non-Southern Corridor competitor: South Stream**

South Stream AG is a joint venture of OAO Gazprom (50%), Italian company Eni SpA (20%), German Wintershall (15%) and Electricité de France (15%). It is a mammoth project whose central piece would be a 900 km-long pipeline on the Black Sea's seabed, linking Russia to Bulgaria. From there it would branch out in two onshore routes: a northwestern branch running from Bulgaria to Serbia, Hungary, Slovenia and Austria, and a southwestern one, going to Greece and then southern Italy, via a marine interconnector. However, the precise "geography" of these routes kept vacillating along with the political shifts upsetting the project's feasibility.

Technically- and financially-wise, South Stream is a hugely difficult venture. The planned volume was boosted from an initial 31 bcma to no less than 63 bcma (*dpa*, 2009) at a prohibiting initial cost of €24 billion, according to Gazprom's own estimate – later revised downwards to €15.5 ([www.gazprom.com](http://www.gazprom.com), 2010). According to the project's website (<http://south-stream.info>), South Stream is "aimed at strengthening European energy security" by eliminating "transit risk", as "another real step toward executing the Gazprom strategy to diversify the Russian natural gas supply routes" (*Euractiv*, 2011a). This, however, is not only unlikely, but also ironic. South Stream seems in fact to serve a different set of objectives:

- (1) To discourage Nabucco's progress. Although the South Stream consortium's official stance is that "South Stream and Nabucco are not competitors. Both projects will play a significant role in supplying natural gas to European consumers" ([south-stream.info](http://south-stream.info), 2011), it stands to reason that Gazprom's primary concern is not to lose any market in Europe. Given Russia's declining gas output and diminishing access to the Caspian states' reserves, Gazprom would be better off if no pipeline at all connected the Caspian Basin to world markets – or, at least, no large scale, strategic pipeline;
- (2) To serve as a lever of coercion against Ukraine in potential future gas spats, such as those of 2006 and 2009. Indeed, in 2007 the main public argument for the construction of South Stream was the need to bypass the "unreliable" Ukraine. At present, Ukraine's sidestepping has been in part been already accomplished, with the completion of Nord Stream's

first leg. However, doing the same on Ukraine's southern flank is nowadays both economically unrealistic and politically unnecessary.

After President Yanukovich's 2010 election, a merger formula between Gazprom and Naftogaz has been under negotiation – although Kiev's decision-makers and business circles fully realize that the country's autonomy is at stake. Importantly, the economic viability of Ukraine's heavy petrochemical and steel industry crucially depends on abundant and cheap natural gas from Russia. Kiev has advanced the notion of offering Gazprom a substantive share in the Ukraine's gas transit system in a would-be Ukrainian-Russian-European consortium, in return for a price-cut in its massive gas imports. With the April 21, 2010 barter agreement signed by Presidents Yanukovich and Medvedev in Kharkov, Ukraine agreed to extend the lease of the Russian Black Sea Fleet in Sevastopol (Crimea) for 25 years after 2017 (plus an automatic extension of five years) in exchange for a 30 percent price cut for the next ten years – a discount estimated to amount to \$40 billion (Felgenhauer, 2010). Thereafter, since the agreement reached in 2009 with Gazprom by Yulia Tymoshenko (a deal that brought her in jail, almost three years later) was on the way to have Ukraine pay market prices starting January 2012, Kiev restarted negotiations with Moscow in the desperate need of keeping the price level under \$400 per thousand cubic meters. Again, the negotiations included substantive political elements. At stake were not only the ownership over Ukraine's pipelines and storage system, but also its interest in concluding association and free trade agreements with the European Union, and Russia's counter-pressure that Kiev join the 2010 created Russia, Kazakhstan and Belarus customs union. As late as November 10, 2011, a new gas deal between Russia and Ukraine seems to be almost sealed (Stratfor, 2011). At the time we were writing this paper, the content of this agreement was not publicly known. It is though certain that a substantive political trade-off will take place.

Gazprom's political tactics related to South Stream has been to divert political support away from Nabucco. One by one, the Nabucco consortium's government and leading companies did also join South Stream. Romania was among the last ones to cave in, but it did eventually in the summer of 2010, when Bulgarian Prime Minister, Boyko Borisov, expressed public doubts about South Stream's viability (Socor, 2010b). Romania jumped in and accepted Gazprom's offer to become the project partner on the Western shores of the Black Sea. On June 16, 2010 the Romanian energy minister Adrian Videanu discussed in Moscow with Gazprom's CEO, Alexei Miller, the sequence of steps needed to bring Romania into the South Stream undertaking. Eventually, though, after a series of politico-diplomatic moves, Sofia did sign on November 13, 2010 an agreement with Gazprom regarding the creation of South Stream Bulgaria, a fifty-fifty joint venture. On the occasion, Gazprom's CEO Alexei Miller emphasized that "Bulgaria can no longer be replaced by Romania as the



European hub of the Russian-sponsored South Stream gas transit pipeline (Novinite, 2010).

Nonetheless, apart from its political success, South Stream has made little convincing progress in its own terms. A telling move was the demand by Prime Minister Vladimir Putin to energy minister Sergei Shmatko, on March 9, 2011, to consider replacing South Stream's offshore section with an LNG project that would transport liquefied gas from the Russian Black Sea coast to Bulgaria. This certainly adds to the skepticism that has all along accompanied Gazprom's commitment to such an exorbitant undertaking. But it also achieves several political advances in one shot: first, it downsizes considerably the projected capacity from 63 to just 12 bcm – the average size of a large LNG facility. Second, it has managed to create confusion around the LNG-based AGRI, entering in direct competition to it. As hinted upon previously, it is doubtful that the Black Sea Basin has the scale to support commercially and financially one costly LNG project, let alone two at the same time.

## **2. Conclusion**

The discussed gas pipeline projects play a defining role in the current energy security environment of the Black Sea Region. In effect, as emphasized by Dubien and Vaquer I Fanes (2010: 4), “the race for control over the south-eastern route of gas supply into Europe” is truly one of the “main drivers of change in the Black Sea security environment”. Energy politics is a key factor in Moscow's foreign policy. Importantly, it is not only aimed at securing demand for Russia's most valuable exports; it also addresses Moscow's goal to achieve political and economic control of a number of strategically important states in its vicinity.

Against this background, the various interests and perceptions of the EU Member States in energy matters have led to a ‘collectively dissociated’ energy policy. The European Commission's political initiatives of 2011 to achieve a unified diplomatic stance in dealing with the EU's energy providers, to commit substantive financial support in order to leverage badly needed private investments into energy projects, but also to streamline and speed up the planning and approval processes for energy infrastructure is a significant step forward. Indeed, political changes in Brussels' energy policies were needed with respect to the internal energy markets – i.e., incentives supplementary to the injunctions of the Third Energy Package – and its largely dysfunctional Emission Trading Scheme (ETS) – essentially due to a year-long over-supply of permits. But to the point of our discussion, the EC's security of supplies policies in the Black Sea Region, surrounding the Southern Gas Corridor, may well have come too late to make a sizeable difference in the access to Caspian

gas. The market forces at work within SOCAR's current tender for the Shah Deniz 2 production will most likely select a smaller-scale, adjustable interconnector, which will likely cut off the Turkmen gas from a westward transport corridor. As the regional landscape now presents itself, Moscow seems to have won a politico-economic battle in competition in which it has along had high stakes.

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